

BOARD OF TAX APPEALS
STATE OF LOUISIANA

REGGIE J. OUGEL
PETITIONER

DOCKET NO. 12536C

VERSUS

KIMBERLY ROBINSON, SECRETARY,
DEPARTMENT OF REVENUE,
STATE OF LOUISIANA
RESPONDENT

ORDER WITH WRITTEN REASONS

On July 14, 2021, this matter came before the Board for hearing on the merits. Presiding at the hearing were: Judge Tony Graphia (Ret.), Chairman¹, and Vice-Chairman Cade R. Cole.² Present before the Board was Seth Bagwell, attorney for Reggie J. Ougel (“Taxpayer”) and Aaron Long representing Kimberly Robinson, Secretary, Department of Revenue, State of Louisiana (“Department”). At the conclusion of the hearing, the matter was taken under advisement. The Board now issues this Order with Written Reasons.

Background

Taxpayer appeals from a Notice of Assessment and Notice of Right to Appeal to the Louisiana Board of Tax Appeals bearing Letter ID L0090766816 (the “Assessment”), for Individual Income Tax for the tax periods: December 31, 2016, through December 31, 2018 (respectively the “2016 Tax Year,” “2017 Tax Year,” and “2018 Tax Year,” collectively the

¹ Following the hearing, Judge Tony Graphia’s term expired and he retired from the Board, and thus is not participating in the rendering of this Order with Written Reasons.

² Then Board Member Francis J. “Jay” Lobrano recused himself prior to the hearing.

“Tax Years at Issue”). The Assessment shows tax due in the amount of \$20,081.91, interest calculated to September 8, 2020, in the amount of \$3,920.01, late payment penalty calculated to September 8, 2020, in the amount of \$2,275.89, and an understatement penalty in the amount of \$3,012.29, for a total amount of tax, penalty, and interest due in the amount of \$29,290.10. By joint stipulation the Taxpayer conceded the following amounts: \$900 in capital gains for the sale of boat motors in the 2017 Tax Year, \$254.48 of adjustments to Schedule A of his tax returns for the Tax Years at Issue, and \$167.84 for the purchase of a handbag.³ During the hearing, Taxpayer further conceded that he incorrectly claimed \$1,763.70 of depreciation on a BMW purchased in 2018.⁴ After removing the foregoing stipulated amounts, the remaining amount in dispute is \$25,402.25.

Taxpayer owns and operates Ougel Diving Services, LLC (“ODS”). Taxpayer’s work for ODS consists of diving underwater to perform repairs and maintenance on vessels. Typically, this means removing debris, such as rope or cable that has become entangled in a ship’s propeller. Taxpayer also plugs leaks and removes barnacles from the undersides of ships. Taxpayer performs most ODS work in Port Fourchon. ODS’s clients and their vessels are mostly in the oil and gas business.

³ Taxpayer testified that the deduction for the handbag on his 2018 Schedule C was a mistake.

⁴ Taxpayer claims that he claimed deduction on the BMW in reliance on the faulty of advice of a tax preparer.

In addition to his work for ODS, Taxpayer is himself employed in the oil and gas industry. During the Tax Years at Issue, he was a salaried employee of Galliano Marine Services, LLC (“Galliano”). Galliano is a part of the conglomerate Edison Chouest Offshore (“Edison Chouest”). According to the Taxpayer the majority of the market for ODS’s services are businesses within the Edison Chouest conglomerate.

Taxpayer claims to have conceived of the idea of ODS while working for Galliano. In the course of his work, he observed vessels incurring significant costs and suffering long downtime when their propellers became entangled with underwater debris. The debris rendered the vessels inoperable, and they had to be slowly towed to port for repair. Taxpayer saw an opportunity to bring the repair services to the vessel by using his own boat, diving equipment, and skills.

Taxpayer began work through ODS in 2015. In that year, ODS generated \$2,000 in gross receipts and invoiced two jobs. First year expenses were reported to be \$73,082.00. Taxpayer would continue to perform jobs and promote his business for the next five years. Taxpayer’s reported expenses increased each year until they peaked in 2018 at \$129,060.00.

Taxpayer’s income from ODS did not begin to approach 50% of its expenses until 2019, even before factoring in depreciation. Nevertheless, reported receipts grew in four of the five years after 2015 (2016: \$16,000.00; 2017: \$38,000.00; 2018: \$40,000.00; 2019: \$39,477.00; 2020: \$59,671.00. Reported expenses also decreased in 2019 and 2020. As a

result, in 2020, Taxpayer reported a profit on his Schedule C for the first time.

During the Tax Years at Issue, Taxpayer earned a very respectable salary working for Galliano. Thanks to his reported Schedule C losses from ODS, however, he paid no income tax. In fact, his losses from ODS, after accounting for depreciation, led to his receipt of sizable income tax refunds in each of the Tax Years at Issue.

Eventually, Taxpayer's Schedule C losses were audited by the IRS. The IRS opened its audit of the Taxpayer's federal tax return for the 2017 Tax Year in November 2019. The IRS auditor eventually concluded that Taxpayer evidenced a profit motive for operating ODS, and had plans for improving the business. The auditor's findings are set forth in his report dated December 16, 2019. This report was admitted into evidence as Exhibit P-78.

Also in December of 2019, the Department commenced its own audit for the Tax Years at Issue. Unlike the IRS auditor, the Department's auditor re-characterized Taxpayer's claimed expenses for ODS as hobby losses. That conclusion ultimately led to the Assessment and this appeal. Now, the question of whether Taxpayer operated ODS for profit or as a hobby is the core dispute in this case.

To perform his work for ODS, Taxpayer must equip a wetsuit, harness, lead-weighted belts, specialized gloves, boots, knives, underwater tools, and other special equipment depending on the job. Taxpayer often does not know what kind of debris is jammed in the ship or its propeller. The water that he dives into is pitch black with no

visibility. Taxpayer must feel his way around the bottom of the ship, using his knowledge of marine vessels. Occasionally someone inside the ship helps guide him by tapping against the hull.

Taxpayer's work for ODS is dangerous. For example, a ship's propeller may be immobilized by metal cable under tensile stress that can unwind and strike Taxpayer once it is cut free. The water is sometimes dangerously cold. So much so that he will not be able to spend more than 15 minutes at a time underwater. Taxpayer's air hose can be severed and he must use special underwater communication equipment to keep contact with a crewmember in case that happens. While underwater, Taxpayer is further exposed to dangers from marine life and other vessels.

Work slowed while the oil and gas industry was struggling, and Taxpayer sought other opportunities for ODS. He attempted to develop a second line of business by pressure washing barnacles off of the undersides of leisure boats at a marina. He claims to have purchased a Utility Vehicle ("UTV") in order to drive up to the boats in the marina. However, this line of business was ultimately not profitable.

Taxpayer described two other businesses like his. One was an individual operation that closed when its diver retired in 2015. Taxpayer testified that he consulted with the retiring diver and attempted to pick up some of his customers. The only other competitor that Taxpayer knows of is located in Belle Chasse. The Belle Chasse operation is a full-time business, but it is an hour away from the market that Taxpayer serves.

Taxpayer claimed significant expenses for entertainment, meals, donations, gifts, and travel. Taxpayer's business justification for these expenses was that they were incurred to develop clientele. Taxpayer's development efforts focused on people working in the oil industry who are connected to marine ventures, as they may eventually need the services ODS provides. Taxpayer's business development supposedly entails boating and fishing trips and taking people out to dinner. Taxpayer also claimed to have brought a potential client on a ski trip. Taxpayer's donations include sponsoring a fishing rodeo, Christmas gifts, and taking a high school cheerleading team on a boating excursion.

ODS's charter has been revoked twice. Taxpayer explained that this was for his inadvertent failure to pay an annual \$25 fee. He attributed the failure to not getting the notice that the fee was delinquent. He further testified that he paid the fees and the charter was reinstated (both times).

The Department presented screenshots from Taxpayer's social media. Some photos appear to show Taxpayer fishing with his family on a boat. Other pictures show Taxpayer and his family using the UTV for recreational purposes. Taxpayer admitted that, on about seven occasions during the Tax Years at Issue, he went took his family on recreational fishing trips on the boat that he claimed as a business expense.

Law and Analysis

Both parties direct their arguments towards 26 CFR § 1.183-2 and the nine factors for determining whether an activity is engaged in for profit. Those factors are:

- (1) Manner in which the taxpayer carries on the activity. . . .
- (2) The expertise of the taxpayer or his advisors. . . .
- (3) The time and effort expended by the taxpayer in carrying on the activity. . . .
- (4) Expectation that assets used in activity may appreciate in value. . . .
- (5) The success of the taxpayer in carrying on other similar or dissimilar activities. . . .
- (6) The taxpayer's history of income or losses with respect to the activity. . . .
- (7) The amount of occasional profits, if any, which are earned. . . .
- (8) The financial status of the taxpayer. . . .
- (9) Elements of personal pleasure or recreation. . . .

The above is not an exclusive list of factors, and no single factor or “mathematical preponderance” of these factors is determinative. *Westbrook v. Comm’r*, 68 F.3d 868, 876 (5th Cir. 1995).

Manner in which the taxpayer carries on the activity

This factor considers whether the taxpayer carried on the activity in a businesslike manner and maintained complete and accurate books and records. A profit motive can be evidenced by conducting the business in a substantially similar manner to other activities of the same nature which are profitable. The taxpayer may also be able to show that it changed operating methods, adopted new techniques, and/or abandoned unprofitable methods.

In applying this factor, the United States Tax Court has asked whether the taxpayer's records are sufficient to enable informed business decisions. See *Dodge v. Comm'r*, T.C. Memo. 1998-89; 1998 WL 88175, at *4. A taxpayer's business records can help show a profit motive by their usefulness to the particular taxpayer's efforts to learn and adapt their business practices. See *Lamb v. Comm'r*, 71 T.C. Memo (CCH) 2665 (T.C.1996), 1996 WL 144369, at *2 (approving of fisherman's separate account and log with coordinates of good fishing spots).

The Department points to the absence of a written business plan, balance sheet, general ledger, or cash flow statements. However, the regulation does not proscribe specific methods of bookkeeping. The Taxpayer in this case kept carefully organized receipts and a log of expenses segregated by category. He kept copies of invoices from ODS jobs. He also maintained a separate bank account for ODS, although that account was hardly used.

These are the sort of records that are useful in preparing tax returns. However, that does not mean that they were useful in making business decisions. It is concerning that Taxpayer incurred such significant business development expenses, but did not maintain any kind of written plan as to what his strategy or goals were. This factor weighs slightly against the Taxpayer.

The expertise of the taxpayer or his advisors

This factor examines the taxpayer's preparation for the activity by extensive study of business, economic, and scientific practices, or consultation with those who are expert therein. A taxpayer operating a

for-profit enterprise would presumably adopt the best practices arrived at by these studies. However, this factor allows for the possibility that an entrepreneur might not adhere to learned wisdom if attempting to develop new techniques.

Taxpayer formulated his business model based on his own observations during his W-2 employment. The evidence also shows that Taxpayer consulted with a similar business in 2015. Given the relative novelty of his enterprise, the absence of additional research is understandable. Under the circumstances, the Taxpayer made his best attempt to obtain expertise outside of his own experience. This factor weighs in favor of the Taxpayer.

The time and effort expended by the taxpayer in carrying on the activity

This factor looks at whether the taxpayer devoted their personal time to the endeavor. This is especially significant if the endeavor is not of a substantially personal or recreational nature. The taxpayer may also show an intent to earn a profit by withdrawing from another occupation.

Taxpayer's work performing underwater repairs was difficult, dangerous, and certainly not a recreational activity. However, Taxpayer appears to have spent more time engaged in purportedly promotional activities for the business. These activities, such as vacations and fishing trips, were recreational in nature. Furthermore, the Taxpayer maintained his salaried employment, rather than dedicating his time solely to ODS. This factor weighs slightly against the Taxpayer.

The taxpayer's history of income or losses with respect to the activity

This factor takes into account the customary period necessary to establish profitability for a new venture. Sustained losses beyond that period may indicate that the activity is not engaged in for profit. However, this factor also allows for leniency when periods of unprofitability result from circumstances outside the taxpayer's control. On the other hand, a series of profitable years would indicate a profit motive.

For the first four of the five Tax Years at Issue, ODS sustained substantial losses. In year five, however, ODS finally turned a profit. The Department characterizes the profit as nominal. This characterization is contradicted by a cursory examination of ODS's stipulated gross receipts and expenses. A substantial component of ODS's expenses is from depreciation. Depreciation is not an out-of-pocket expense. If depreciation is removed, Taxpayer enjoyed a profit of \$31,164.00 in 2020.

There is no market data to establish the expected time necessary for a novel enterprise like ODS to turn a profit. Moreover, no statistical or expert evidence on the subject was brought forth. Even if some evidence were available, the unexpected downturn in the oil and gas industry would make a comparison difficult. The Board finds that the steady growth in gross receipts over the Tax Years at Issue supports Taxpayer's overall contention that the business was operated with the intent to obtain a profit. This factor weighs in the Taxpayer's favor.

The amount of occasional profits, if any, which are earned

This factor weighs the realization of, or opportunity for, profit compared to the losses incurred in the activity. An occasional small profit does not mean that an activity was engaged in for profit if the activity generates large losses, or if the taxpayer made large investments in the activity. However, the opportunity for substantial profit from a speculative venture is generally sufficient to demonstrate a profit motive even though the actual profits are small and infrequent.

The Taxpayer here aimed to build a market for a novel business venture. That is a risky proposition. However, the greater risk corresponds to greater potential rewards. If the business was successful. Taxpayer would have a dominant presence in the market that he, in many respects, created for himself. He would also have a competitive advantage through the relationships he forged with the majority of potential clients. Taxpayer's losses are comparatively reasonable in light the opportunity for substantial profits. This factor weighs in favor of the Taxpayer.

The financial status of the taxpayer

This factor suggests that if the taxpayer does not have substantial income from capital or other sources, then the activity is more likely to be a profit-seeking venture. Contrarily, if the activity generates losses that offset tax liability from other income, then the activity is less likely to be engaged in for profit. A profit motive is particularly unlikely when the activity is of a personal or recreational nature.

Taxpayer's salary from his W-2 employer was another source of income. His losses from ODS offset his W-2 income and contributed to his receiving tax refunds. Further, Taxpayer's promotional fishing trips, vacations, and meals were recreational in nature. This factor weighs against the Taxpayer.

Elements of personal pleasure or recreation

Obviously, if there are personal or recreational reasons for the activity, then a profit-seeking intent is less likely. However, the regulations caution that it is not necessary that the activity be engaged in exclusively for the purpose of obtaining maximum profits. Further, the regulations also state that the fact that the taxpayer derives personal pleasure from the activity does not necessarily negate the existence of a profit motive.

As stated above, the diving repair work was not recreational or pleasurable. With respect to expenses incurred in performing that work, this factor weighs in favor of the Taxpayer. However, the Taxpayer's expenses for promoting his business were recreational. With respect to those expenses, this factor weighs against the Taxpayer. Thus, on the whole, this factor weighs neither in favor of, or against, the Taxpayer.

Conclusion as to Hobby-Loss Rule

Considering all of the above factors, the Board finds that the Taxpayer did operate ODS with a profit motive. The nature of Taxpayer's work for ODS when making underwater repairs is dangerous, difficult, and not in any way recreational. Furthermore, the Taxpayer's reported profits and losses show a steady improvement in the business's outlook

over the Tax Years at Issue. Finally, the Taxpayer's efforts to research his business from existing similar endeavors shows an intent to operate the business for a profit.

However, the Taxpayer has not provided evidence to explain how the exorbitant expenses incurred in promotional and recreational activities were ordinary and necessary expenses of the business. The Taxpayer did not keep a business plan or other record to show a pre-conceived strategy behind his significant expenditures on fishing trips, meals, vacations, and the like. It is also fair to question his methods for distinguishing recreational and business expenses. At trial, he described a practice of keeping business related receipts in a certain part of his wallet. However, there were several receipts called into question during the hearing, and he admitted that some of these were unrelated to ODS. In light of these unresolved issues with the Taxpayer's proof, the Board finds that expenses related to promotion of the Taxpayer's business were not properly substantiated. Accordingly, the Board will now examine each category of item at issue and determine whether it was allowable as a business expense deduction:

Diving Equipment & Gear

Taxpayer's diving gear and equipment, including his underwater communication equipment, was vital to his work. Taxpayer's diving activities were dangerous, grueling, and not recreational in nature. Taxpayer is entitled to deduct these expenses.

Boat (Expenses, Repairs, Electronics, Fuel)

Taxpayer used the Boat in both recreational activities and dive jobs. Like the diving gear, the Boat was a vital part of the non-recreational element of Taxpayer's business. Accordingly, Taxpayer may deduct expenses for the boat.

Camper / RV & Related Rental, Internet

Taxpayer made rental payments to Bridgeside Trailer Park in Grand Isle for keeping his Camper there. Taxpayer consistently kept the Camper in Grand Isle from mid-to-late April through August (which is, according to the Department, prime fishing season). According to Taxpayer, the Camper serves as a temporary staging location for ODS in the course of repair work performed in the area of Port Fourchon. However, Taxpayer admitted on cross examination that he performed only handful of jobs out of Grand Isle. Furthermore, evidence presented at the hearing showed that the Camper was used in part for recreational purposes. The Board finds that the purported business expenses related to the camper were not properly substantiated, and are not allowable as deductions.

Utility Vehicle

Taxpayer claimed that he purchased the UTV to access pleasure boats at a marina. This was supposedly part of Taxpayer's strategy to adapt to a slower oil and gas industry. The UTV can seat half a dozen passengers, far in excess of Petitioner's business needs. The photographic evidence in the record shows a vehicle that is intended for recreational, not business use. Taxpayer is not entitled to deduct expenses for the UTV.

Gifts, Donations

Taxpayer paid to have ODS featured as a sponsor on fishing rodeos. Taxpayer's Exhibit P-17 shows a promotional shirt for one such event, listing ODS as a "Platinum Sponsor," as well as receipts for each of the Tax Years at Issue showing the same. Taxpayer is entitled to deduct the expenses of sponsoring the fishing rodeos. However, Taxpayer did not demonstrate that any other gifts or donations were ordinary and necessary business expenses.

Fishing Equipment, Meals, Groceries, Entertainment, Travel

Taxpayer's expenses for meals, entertainment, groceries, and travel are disproportionately large in relation to his revenues. Taxpayer claims to have spent tens of thousands of dollars on fishing rods and reels to entertain potential clients. These expenses were not shown to be incurred as part of any documented plan for growing his business. Furthermore, Taxpayer admitted to claiming hotel room expenses attributable to his wife and children. Taxpayer's fishing equipment, meals, groceries, entertainment, and travel are predominantly personal and recreational expenses, and are not valid business deductions.

Uniforms, Attire, Clothing

The items listed on Taxpayer's receipts for purported uniforms, attire, and clothing were shown to include items in the nature of personal clothing, rather than business attire. Taxpayer is not entitled to deductions for these expenses.

Company Phone

Taxpayer claimed that he required a phone line specifically for ODS. Taxpayer explained that he worked with potential ODS clients during his employment with Galliano Marine. He was not permitted to pursue his own business with the phone provided by his employer. Accordingly, he made ODS calls from a separate line. This is a reasonable expense of the business. Taxpayer may deduct expenses for his separate ODS phone line.

Conclusion and Order

The parties are HEREBY ORDERED to submit an agreed-upon Judgment in conformity with the reasons expressed herein, calculating the tax due from Taxpayer, along with penalties, and interest as provided for by law within 60 days of the signing of this Order.

The parties are FURTHER ORDERED, if they are unable to agree on the form of the Judgment, to submit proposed Judgments with supporting memoranda within 60 days of the signing of this Order.

Signed in Baton Rouge, Louisiana, on this day

May 4, 2022.



VICE-CHAIRMAN CADE R. COLE
LOUISIANA BOARD OF TAX APPEALS